Vietnam's economy

Currency:	Dong (VND)
Exchange rate:	US$1 = VND 16,183 (January 2004)
GDP:	$168.1 billion (PPP*, 2001 est.)
GDP growth rate:	4.7% p.a. (2001 est.)
GDP per capita:	$2,100 (PPP*, 2001 est.)
GDP composition by sector:	*Agriculture*: 25% *Industry*: 35% *Services*: 40% (2000 est.)
Inflation rate:	2.9% p.a. (2002)
Labour force:	38.2 million (1998 est.)
Labour force by occupation:	*Agriculture*: 67% *Industry and services*: 33% (1997 est.)
Unemployment rate:	6.4% (2000 est.)
Government budget in % of GDP:	*Revenue and grants:* 18.9% *Expenditures:* 25.4% (2001)
Population below poverty line:	37% (1998 est.)
Annual production of food staples:	34,254 thousands of tons, with 7.5% annual increase (1999)
Industries:	Food processing, garments, shoes, machine building, mining, cement, chemical fertiliser, glass, tyres, oil, coal, steel, paper
Industrial production growth rate:	10.4% p.a. (2001 est.)
Agricultural products:	Paddy rice, corn, potatoes, rubber, soybeans, coffee, tea, bananas, sugar, poultry, pigs, fish
Electricity production:	25.775 billion kWh (2000)
Electricity production by source:	*Fossil fuel:* 40.74% *Hydro:* 59.26% *Nuclear:* 0% (2000)
Electricity consumption:	23.97 billion kWh (2000)

Note * based on purchasing power parity (PPP).

Sources: CIA (2002) *The World Factbook 2002*, Washington, DC: CIA; ADB (2001) *Key Indicators 2001: Growth and Change in Asia and the Pacific*; *VVG Economic Indicators, August 2003*, available online at http://www.vvg-vietnam.com/economics_cvr.htm#Rates; IMF (2002) *Vietnam: Selected Issues and Statistical Appendix*, IMF Country Report No. 02/5.

6 Growth and reform since the Eighth Party Congress

Ari Kokko

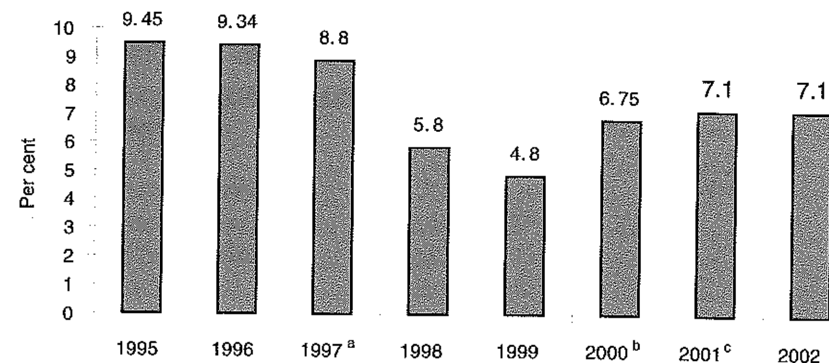
At the time of the Eighth Party Congress of the VCP in 1996, Vietnam appeared set to join the ranks of 'Asian tiger' economies. The economic reform programme introduced after the Sixth Party Congress in 1986 had gradually decentralised decision-making and replaced central planning with markets and prices, with impressive results. In agriculture, chronic food deficits turned into large export surpluses. Industrial development accellerated when individual firms, mainly state-owned enterprises (SOEs), were allowed to determine their own prices and production. Foreign trade grew rapidly, albeit from a small base, and thousands of foreign investors were attracted to Vietnam, bringing with them more than US $2 billion per year by the mid-1990s. Altogether, the reforms translated into annual gross domestic product (GDP) growth rates exceeding 9 per cent in the mid-1990s, with corresponding improvements in living standards for large segments of the population.

However, the late 1990s were disappointing. The GDP growth rate fell gradually from its peak at 9.5 per cent in 1995 to below 5 per cent in 1999 (see Figure 6.1). Both import and export growth rates stagnated and the inflows of foreign direct investment (FDI) fell dramatically after 1997. The downturn was caused by a combination of domestic structural weaknesses and spillovers from the Asian crisis. The first signs of recovery did not appear until 2000, when stronger export demand boosted production. By 2001 and 2002, growth rates were firmly back in the region of 7 per cent.

The purpose of this chapter is to make a brief assessment of selected economic developments in Vietnam since the Eighth Party Congress in 1996. After a review of the development debate in the mid-1990s, the chapter focuses on some major challenges for economic policy-making, especially: trade policy, SOE reform, and the private sector. A key question is: Do recent improvements in economic performance mean that the structural problems plaguing the Vietnamese economy during the second half of the 1990s have now been remedied?

Vietnam in the mid-1990s: growth with structural imbalances

In the mid-1990s, Vietnam was considered one of the most promising markets



Notes

a ADB statistics: 8.2%

b World Bank statistics: 6.8%; IMF statistics: 5.5%

c World Bank statistics: 6.8%; IMF statistics: 4.75%; ADB statistics: 7%

Figure 6.1 Vietnam GDP growth (%), 1995–2002

Source: Vietnam Government Statistics Bureau.

planning to a market-oriented economy, which started officially in 1986, had led to dramatic improvements in economic performance. The GDP growth rate averaged almost 8 per cent per year during the period 1990–5, with over 9 per cent recorded in 1995 and 1996. Domestic savings and investment increased in absolute amounts as well as in shares of GDP. Exports grew from 25 per cent of GDP in 1990, to 33 per cent in 1995, with even faster growth for imports. Foreign direct investment emerged as an increasingly important source of capital and technology, with the inflow of FDI reaching US $2.3 billion (or 11 per cent of GDP) in 1995. In addition to high growth rates, the reform programme produced macroeconomic stabilisation. Most importantly, the rate of inflation was reduced from over 60 per cent in 1990 to less than 13 per cent in 1995, the current account of the government budget recorded a surplus by 1994, and the financing of the current account deficit in the country's balance of payments did not appear to be any major problem.

The reforms also contributed to Vietnam's integration into the world economy. Inflows of overseas development aid (ODA) increased significantly from the early 1990s, several bilateral trade agreements with foreign countries were established, the US embargo was lifted in early 1994, and Vietnam joined the Association of Southeast Asian Nations (ASEAN) in July 1995. Vietnam's relations with multilateral financial institutions such as the World Bank, the Asian Development Bank (ADB) and the International Monetary Fund (IMF) were normalised; by 1995, Vietnam held a Structural Adjustment Credit (SAC) from the World Bank and an Enhanced Structural Adjustment Facility (ESAF) from the IMF. These credits were important, not only because they provided financial resources, but also because they signalled that Vietnam's economic development was progressing satisfactorily. Both SAC and ESAF are normally granted on condition that the recipient country

pursues 'appropriate' policies when it comes to structural reforms and fiscal and monetary management. One consequence of the perceived success of reforms during the early 1990s was that the Vietnamese authorities revised their economic targets for the period from 1991 to 2000. Instead of aiming for a doubling of the country's GDP over this period, as was originally intended before the Seventh Party Congress in 1991, the target was changed to a doubling of GDP per capita (Socialist Republic of Vietnam [SRV] 1994). Assessing the achievements of the reforms, many foreign observers concurred, concluding, for example, that 'Vietnam appears well-positioned to become a new East Asian "dragon"' (Irvin 1995: 725).

However, these impressive achievements could not completely hide some of the structural and systemic weaknesses of the economy. By 1996, donors and foreign observers had highlighted several problems related to the import-substituting trade regime and the role of the state, in particular the continuing reliance on SOEs as the main vehicle of development (Kokko and Zejan 1996; Ljunggren 1996; Mallon 1996; United Nations Development Programme [UNDP] 1996).

On trade policy, concerns focused on the distorted incentives provided by the complex, non-transparent and highly restrictive trade regime. The combination of tariffs, quotas, import licensing requirements, foreign exchange controls and various other trade barriers created strong incentives in favour of import substitution in consumer goods and selected heavy industries – and a bias against export-oriented production. One paradoxical result was a rapid increase in imports: import-substituting industry in Vietnam, as elsewhere, was heavily dependent upon imported machinery, raw materials and intermediates. Consequently, although exports grew rapidly, import growth was even faster, resulting in growing trade and current account deficits. By 1995, the current account deficit exceeded US $2.6 billion, or 13 per cent of GDP. Several problems were imminent. Would it be possible to finance large deficits without endangering future growth and macroeconomic stability? How would Vietnam's commitments to liberalise trade from around the year 2000 – mandated, for example, by Vietnam's membership of the ASEAN Free Trade Area (AFTA) and ambition to join the World Trade Organisation (WTO) – be realised? Would the promises to reduce tariffs be neutralised by the emergence of strong interest groups benefiting from, and therefore lobbying for, continued protectionism?

The last question was intimately related to concerns about the role of SOEs. These were the main beneficiaries of Vietnamese import substitution, in many cases in joint ventures with foreign investors. Although the foreign joint venture partners provided badly needed technology and skills, it was still clear that most SOEs operated with obsolete machinery and equipment, with perhaps one-third of the capital stock being completely useless (Le Dang Doanh 1996). The Central Institute for Economic Management (CIEM 1997) reported that most state enterprises were running at a loss and that only 300 enterprises accounted for 80 per cent of the SOE sector's contributions to the state budget. Many SOEs survived only thanks to loans from other state enterprises and preferential credits from state-owned banks, creating a significant debt burden (although the absence of transparent accounting practices still makes it impossible to quantify the total

amount of SOE debt). It was not only uncertain whether high and sustainable economic growth could be achieved in a system almost entirely based on state-owned industry: the combination of import substitution and SOE dominance created additional problems. Protection from foreign competition was not expected to contribute to badly needed SOE reforms, including stricter performance requirements, harder budget constraints, and increased efficiency. On the contrary, it was feared that isolation from international markets would allow weak firms to survive without having to undertake necessary reforms.

The fact that the beneficiaries of protectionism were also the most powerful actors in the Vietnamese economy was another cause for concern. The SOEs (sometimes in joint ventures with foreign multinational corporations) were economically important, but also intimately connected with various levels of political decision-making, and in a position to use their political influence to oppose trade liberalisation or other reforms that might reduce their privileges. The lack of a detailed publicised time plan for promised, future tariff reductions increased the risk for this kind of backlash, since it implied that the scheme for trade reform was still open for negotiation.

Another area with severe problems was the banking sector, where lending to inefficient SOEs had created large stocks of problem credits. Official figures indicated that only 8 per cent of the loans in the banking sector were non-performing at the end of 1995, but the real problems were significantly larger than that. However, weak regulations and accounting practices, together with the repeated rollover of loans to SOEs (including the extension of new loans to service old debt), made it impossible to accurately quantify the problem (IMF 1999). Still, the pressure on the banks' balance sheets was beginning to affect their lending. Most private enterprises had to accept very strict collateral requirements, but were still largely unable to get any medium- or long-term credits. SOEs, on the other hand, were not bound by collateral requirements and other restrictions – after all, the state was not expected to default on its obligations.

The development of the private sector in general was disappointing. Private sector growth was stunted by the complex regulatory environment and the competition from SOEs benefiting from political contacts and privileged access to capital, land and other resources. The GDP share of the domestic private sector, excluding farmers and informal household enterprises, reached only about 7.5 per cent in 1995, while the 'modern' private sector, consisting of limited liability companies and shareholding companies, accounted for at most one per cent of GDP (Webster 1999; Kokko 2000). The lack of a dynamic private sector was worrying, particularly since it was becoming increasingly clear that the inefficient SOE sector would not be able to generate enough jobs for the rapidly growing labour force. In 1995, the SOEs employed only 1.8 million people out of a total labour force of nearly 35 million and over one million new entrants each year. In addition, it was clear that thorough public administration reform would be needed in order to manage reforms in other sectors. Some of the reasons for these reforms were of a structural nature. For instance, at least half of government revenues were generated through protectionism, in the form of direct taxes on trade or

profit taxes from SOEs that were profitable mainly because they could set their own prices. Other reasons focused on the efficiency of public administration. The Vietnamese business environment not only suffered from excessive regulation and red tape: reports of outright corruption were widespread.

The reform agenda

These structural problems and contradictions in economic policy were by no means unknown to the Vietnamese authorities. On the contrary, the agenda for the dialogue between Vietnamese authorities and the multilateral and bilateral donors included all of the concerns discussed above, and several were also addressed in the government's reform plans in the mid-1990s. Some of these plans were summarised in a Policy Framework Paper (PFP 1996) prepared with the assistance of the World Bank and the IMF. This document laid out the country's general economic objectives for the medium term, including detailed reform commitments reflecting agreements with the World Bank and the IMF. Meeting these commitments was a condition for both the Bank's SAC and the Fund's ESAF. A look at these reform plans is helpful in describing Vietnamese expectations and reform priorities at that juncture.

PFP (1996) identified five main areas for reform for the late 1990s: trade and FDI policy, SOEs, the financial sector, the private sector, and public administration. In the area of international trade and investment, the primary aim was to simplify trade regulations. The stated ambition was to abolish import permits and import shipment licenses and to allow all enterprises to engage in international trade. Measures focusing on the foreign exchange market, especially the aim to eliminate all restrictions on current account transactions, were also notable. One reason for these quite radical liberalisation proposals was that the authorities did not anticipate problems in handling a continuing current account deficit: in fact, PFP (1996: 7) expected significant improvements in the current account, and noted that 'over the medium term, some appreciation cannot be ruled out as productivity improves'. This suggests that neither the Vietnamese government nor the multilaterals were, at the time, very concerned about the import-substituting character of the Vietnamese trade regime. As a result, the measures intended to reduce the level of protection were relatively weak. Although the document discussed the need to start preparing to meet AFTA tariff reduction commitments and future WTO accession, as well as the need to eliminate non-tariff barriers to trade, there were no concrete targets or time plans, except for a reduction of the maximum tariff from 100 per cent to 60 per cent. In the FDI area, reform proposals were also marginal, which is not surprising considering the large inflows of funds to Vietnam. For instance, in 1996, inward FDI commitments still amounted to more than US $8.6 billion (see Table 13.2, this volume).

The objectives for SOE reform were more far-reaching, mainly because both the World Bank and the IMF considered this a priority area (World Bank 1995). The State Enterprise Action Plan was expected to stipulate a clear timetable for the restructuring of the SOE sector, including the identification of strategic

enterprises to be retained under government ownership and a programme for the divestiture of non-strategic SOEs. In particular, it was stated that the equitisation of SOEs would accelerate, although no numerical targets were given. In the equitisation process, SOEs are transformed into shareholding companies that are often partially privatised.

The main thrust of the measures intended to support private sector development was on legal reform. Comprehensive revisions of the Commercial Law, Company Law and Private Enterprise Law were announced, with special emphasis on a simplification of the regulatory framework for private enterprise. It was stated that 'licenses will be required only in cases where public safety or national security are involved. For all other businesses, a registration procedure will be introduced that does not require administrative approval' (PFP 1996: 8). In addition, the programme included plans to strengthen land use rights and to improve the transferability of non-agricultural land, in order to develop a market with a level playing field for individuals, private firms, and SOEs.

The reform plans for the financial sector covered two areas. First, the programme included several measures to strengthen the instruments for monetary policy. The primary objective was to start a gradual move away from direct controls (interest rate regulations and credit ceilings) to the use of indirect instruments, such as open market operations. Second, it was clear that the banking system needed to be reformed. In addition to revisions of banking laws and efforts to strengthen banking supervision, the four state-owned commercial banks were to undergo detailed audits, and the findings of these audits were to be used to formulate and adopt detailed reform programmes for each of the banks. The resulting reforms were expected to be quite radical; PFP stated that the programmes:

> will include provisions for increasing bank capital through issuance of shares, recapitalisation where necessary, and reform of operating procedures. These include holding bank management accountable for the commercial performance of the banks, giving the banks the autonomy to determine staffing and salary levels, and freeing them from specific lending directives.
>
> (PFP 1996: 9)

Considering the weaknesses of the banking system, with intimate connections to SOEs, large but undisclosed problem credits, and a lack of experience with market-based operations, it was obvious that the objectives for banking reform were also remarkably ambitious.

Public administration reform also covered two areas. On the one hand, there was an ambition to make the mobilisation of public revenue more efficient. In 1994, taxes on international trade accounted for one-third of total tax revenue, while taxes paid by SOEs comprised half of revenue (PFP 1996: 4). It was understood that the impending trade reforms would reduce these sources of income, and a broader tax base was therefore needed. On the other hand, reforms were needed on the expenditure side as well, increasingly to focus public investment on infrastructure and other projects complementary to private sector investment.

However, these reforms were not implemented as scheduled between 1996 and 1998. One reason was Vietnamese resistance against the ambitious SOE reform plans. It was clear that extensive privatisation and the SOE reforms contradicted the rhetoric of Vietnamese politics as well as the interests of the organisations controlling the SOEs. For instance, the Eighth Party Congress in early 1996 explicitly restated the objective that the state should hold a central position in the country's economic development, which many (though far from all) Vietnamese interpreted to mean that SOEs should dominate industry. Moreover, the reorganisation in 1994 and 1995 of some 2,000 SOEs into 18 General Corporations and over 70 Special Corporations – large conglomerates incorporating the SOEs operating in specific industries or specific geographical areas – essentially identified all large state enterprises as strategically important. Several observers therefore argued that more radical trade reforms should precede SOE reform, because protectionism made many SOEs look artificially attractive to the organisations 'owning' them. For instance, Kokko and Zejan (1996: 26) predicted that 'large-scale privatisation of SOEs will meet fierce opposition as long as the government, individual ministries, regional authorities, and other public entities draw a large share of their revenue from the SOEs they presently control'.

Consequently, in the 1996–7 SAC extension negotiations, the World Bank put additional stress on trade reform. A more open and outward-oriented trade regime would not only generate high growth rates by allowing the economy's comparative advantages to determine the allocation of investment resources, but also facilitate the necessary institutional reforms in the SOE sector. The main new requirement concerned the formulation and implementation of a clear time-bound action programme for trade reform, including schedules for the fulfillment of Vietnam's AFTA commitments regarding tariff reductions and phasing out of non-tariff barriers. In the SOE sector, numerical targets were introduced: at least 150 enterprises were to go through the equitisation process during the 1997–9 period. Strict requirements for the collection and analysis of key financial and performance indicators for the largest SOEs were also discussed.

It turned out to be impossible to reach an agreement. The Vietnamese authorities were unable to present any timetable for trade reform and a World Bank mission in early 1997 failed to get access to requested basic data on the financial status and performance of the SOE sector. The negotiations ended without results, and the structural adjustment credit was discontinued. With rapidly growing exports and around US $2 billion in FDI inflows in 1995 and 1996 (see Table 13.2, p. 186 this volume), Vietnam did not seem overly worried about losing the US $300 million SAC.

It is likely that the disagreements between the Bretton Woods institutions and the Vietnamese authorities would have been resolved during 1997 and 1998 if discussions had proceeded 'normally'. This was not to be the case. In July 1997, conditions changed sharply because of the outbreak of the Asian crisis. Vietnam was not directly hit by the financial turbulence, since the asset markets were weakly developed or controlled by the state. The exchange rate was strictly managed through trade restrictions and controls on the allocation of foreign exchange, there

was no real estate market, nor was there any stock market. Instead, the crisis was felt through a reduction in the inflows of foreign capital. The crisis reduced export growth, because of tougher competition from countries with depreciating currencies and weaker purchasing power among Vietnam's regional trade partners. It also led to a dramatic fall in inward FDI, because the regional investors who had accounted for most of the FDI flows to Vietnam were concerned with their domestic financial problems. The reduced availability of foreign savings revealed the weaknesses in Vietnam's import-substituting development strategy and forced the authorities to introduce stricter controls in foreign trade and exchange markets – the opposite of what was called for in the structural adjustment programmes. In fact, most reform and liberalisation plans, including the formal structural adjustment programmes, were put aside while the causes and consequences of the regional crisis occupied the minds of Vietnamese decision makers.

Thanks to very cautious macroeconomic policies, Vietnam managed to avoid an acute crisis, but growth slowed significantly. Table 6.1 illustrates how developments in many areas stagnated between 1996 and 2000, in particular in comparison with the rapid progress that was recorded during the preceding five-year period. GDP growth fell from over 9 per cent in the mid-1990s to below 5 per cent in 1999. FDI inflows shrank by nearly 60 per cent, and the large net inflows of foreign capital recorded in the mid-1990s turned to outflows. Government revenue as share of GDP fell, and the share of public expenditures devoted to social services stopped growing. Trade was the one area where significant growth was recorded.

It was not until 2000 that clear signs of economic recovery were seen: according to official figures, GDP growth in 2000–1 averaged 6.7 per cent (CIEM 2002: 110). Economic reforms also reappeared on the policy agenda, and disagreements with the multilateral donor agencies have largely been ironed out. Vietnam is one of the pilot countries in the World Bank's current Comprehensive Development Framework

Table 6.1 Macroeconomic indicators, 1991–2000

	1991	*1996*	*2000*
GDP per capita (current US $)	228.0	337.0	390.0
GDP growth (per cent)	6.0	9.3	5.5
Inflation (CPI* increase, per cent)	67.0	5.7	1.7
Aggregate investment (per cent of GDP)	15.1	28.1	25.6
Domestic savings (per cent of GDP)	13.2	17.6	27.3
Foreign savings (net inflows of foreign capital, per cent of GDP)	1.9	10.5	–1.7
FDI inflows (US $ million)	220.0	1,800.0	800.0
Exports (US $ million)	2,042.0	7,330.0	14,449.0
Imports (US $ million)	2,105.0	10,480.0	14,071.0
Government budget revenue (per cent of GDP)	13.5	22.9	21.1
Government expenditure on social services (per cent of GDP)	4.4	7.5	7.5

Source: UNDP (1996); IMF (2002).

Note: * CPI = consumer price index.

programme. In this context, Vietnam has prepared a Comprehensive Poverty Reduction and Growth Strategy (CPRGS) in collaboration with the donor community (SRV 2002), and qualified for Poverty Reduction Support Credits from the World Bank. The CPRGS and the credit facilities linked to it in principle replace the Policy Framework Papers and Structural Adjustment Credits dating from the mid-1990s. But to what extent have the structural problems from the mid-1990s been resolved? The following sections look in some closer detail at what has happened since the mid-1990s in trade policy, SOE reform and the private sector.

International trade and trade policy

Although trade liberalisation was slow in the mid-1990s because of tough opposition from interest groups lobbying for continued protection, there was some cautious progress until the Asian crisis. For instance, most domestic firms were given export rights in January 1997, when import licensing requirements for a large number of consumer goods were eliminated. The Asian crisis put a halt to further reforms. In fact, many trade restrictions were tightened between 1997 and 1999, when authorities felt compelled to restrict imports of 'non-essential' goods in order to allocate the increasingly scarce foreign exchange to the import-dependent industrial sector.

However, concerns about the detrimental long-term effects of high trade barriers grew rapidly. There were also concerns about the need to meet the trade liberalisation targets set up by AFTA. During the first years of AFTA participation, Vietnam had been able to fulfill its formal annual tariff reduction commitments by listing product categories where it had comparative advantages or products that already met the 5 per cent maximum tariff requirement. It was clear that real tariff reductions would definitely be required from 2000, at the latest. Trade reform therefore reappeared on the policy agenda as soon as the acute worries about contagion from the Asian financial crisis dissipated. Trade has arguably been one of the areas with the fastest progress since then.

The most important result in terms of formal policy may be the agreement about a Bilateral Trade Agreement (BTA) between Vietnam and the US, which was signed in July 2000 and ratified in late 2001. The BTA is an important step towards Vietnamese membership in the WTO, and perhaps also a key step in Vietnam's continuing economic reforms. Unlike the AFTA agreement, which is based on consensus and does not prescribe severe sanctions against member countries that do not fulfill their commitments, both the BTA and eventual WTO membership are likely to come with stricter conditions, enforcement and sanctions. Moreover, the BTA allows Vietnam to reap some of the benefits (in terms of access to US markets) early on, while the perceived costs (resulting from opening the Vietnamese market to US firms) will come later. It is possible that these two features will strengthen the reform process: it will be difficult to default on reform promises once they have generated thousands of jobs that may be lost if promises are not fulfilled. The continuing increase in exports is another sign of progress in this area. In 1999 and 2000, exports grew at an annual rate of over 20 per cent, which was more than four times the rate of domestic demand growth. This shows

that an increasing share of the Vietnamese economy is integrated with the international economy, and that there is probably a gradual shift in the balance of power from groups favouring inward-oriented policies to groups relying on contacts with the international economy. In fact, the current Ten-Year Socio-Economic Development Strategy sets up the goal that the export growth rate should be twice as high as the planned 7.5 per cent GDP growth rate during the period 2001–10: if the target is achieved, the ratio of exports to GDP will exceed 90 per cent by 2010.

Other important reforms have been made on the import side. Import tariffs have been reduced gradually, in line with Vietnam's AFTA commitments, and the road map for future tariff reductions under the agreement was published in early 2002. The tariff reduction scheme constitutes an important step to facilitate the long-term planning of Vietnamese producers: with a clear time-bound plan in place, there is less scope for interest groups to lobby for extended protection. Most quantitative restrictions have also been removed, and all domestic enterprises are now allowed to import any goods that are not subject to quotas. Yet some problems remain. The tariff structure remains complex. There is great dispersion of tariff rates in the range from zero to 100 per cent, with higher rates on import-substituting goods and lower ones on imported inputs. This provides high effective rates of protection for local market-oriented industry. Various administrative measures, such as temporary import bans, have also been used to restrict imports of consumer goods. Summarising a review on trade policy, CIEM (2002: 126) notes that this shows how 'many policy decisions tend to aim at "dealing with the problem on a case by case basis" rather than resolving it based on a consistent and overall approach'. Foreign trade transactions can also be controlled and restricted by the allocation of foreign exchange. The State Bank of Vietnam controls and approves remittances of foreign currency abroad, and State Bank authorisation is required to borrow foreign currency, to convert dong to dollars, and to open offshore escrow accounts. Exporters are obliged to surrender a large share (at present 40 per cent) of their foreign exchange earnings to the State Bank. For a long time, state enterprises and agencies had privileged access to foreign exchange (World Bank 1999b), and it is possible that these preferences still apply.

Table 6.2 summarises the Vietnamese balance of payments for the period 1995–2000, confirming the impressive trade growth. The table also provides a comparison between the actual outcome and the projections for 2000 made in PFP (1996). The first notable observation is that although the overall growth rate fell far below the projections from the mid-1990s, this was not due to weak performance in external trade. Both exports and imports in 2000 exceeded the projections from PFP (1996) by a wide margin. In fact, exports were a full 40 per cent higher than predicted only five years earlier. An important part of this export success was an increasing outward orientation among private firms and foreign multinational corporations, both in oil and non-oil sectors. This suggests that problems with lagging growth were mainly caused by weaknesses in other parts of the economy, that is, the more inward-oriented SOE sector.

Table 6.2 Balance of payments, 1995–2000 (US $ million)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	2000 proj.
Trade balance	–3,155	–3,143	–1,315	–981	1,080	378	*–3,404*
Exports f.o.b.*	5,198	7,337	9,145	9,365	11,540	14,449	*10,552*
Imports	–8,353	–10,480	–10,460	–10,346	–10,460	–14,071	*–13,956*
Factor services (net)	–279	–427	–611	–669	–412	–597	*–1,344*
Receipts	96	140	136	133	160	185	
Payments	375	567	747	802	572	782	
Non-factor services (net)	159	–61	–623	–539	–597	–615	*636*
Receipts	2,409	2,709	2,530	2,604	2,668	2,695	
Payments	2,250	2,770	3,153	3,143	3,265	3,310	
Transfers (net)	627	1,200	885	1,122	1,181	1,476	*1,271*
Private	474	1,050	710	950	1,050	1,340	*1,080*
Official	153	150	175	172	131	136	*191*
Current account	–2,648	–2,431	–1,664	–1,067	1,252	642	*–2,396*
Excl. official transfers	–2,801	–2,581	–1,839	–1,239	1,121	506	
FDI inflows (gross)	2,276	1,813	2,074	800	700	800	*2,390*
Equity	1,287	891	1,002	240	301	320	
Loan disbursements	989	921	1,072	560	399	480	
FDI loan repayments	8	55	174	372	603	601	
Medium and long-term loans (net)	–253	98	375	432	605	729	*715*
Disbursements	443	772	1,007	1,121	1,036	1,411	*1,030*
ODA loans	189	336	550	796	970	1,361	
Commercial loans	254	436	457	326	66	50	
Scheduled amortisation	–696	–674	–632	–690	–431	–682	*–315*
Short-term capital (net)	311	224	–612	–644	–1,036	–1,700	*120*
Capital account	2,326	2,079	1,662	216	–334	–772	*3,225*
Errors and omissions	299	71	–2	327	–150	247	

continued ...

Table 6.2 continued

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	2000 proj.
Overall balance (incl. official transfers)	–23	–281	–4	–524	768	116	*384*
Change in net foreign assets (increase –)	–405	–260	–319	–15	–1,316	–116	*–384*
Arrears and rescheduling	428	541	323	126	548	–9,691	
Debt relief	0	0	0	413	0	9,961	
Memorandum items:							
Current account balance in % of GDP	–13.5	–10.5	–6.9	–4.6	3.9	1.7	*–7.7*
Export growth, %	28.2	41.2	24.6	2.4	23.2	25.2	*15.5*
Import growth, %	41.1	25.5	–0,2	–1.1	1.1	34.5	*13.3*
GDP growth rate	9.5	9.3	8.2	3.5	4.2	5.5	*9.5*

Sources: IMF (2000) for 1995–9; IMF (2002) for 2000. Projections for 2000 are from PFP (1996).

Note: * f.o.b. = free on board

Second, it is clear that another major miscalculation in PFP (1996) concerned the scope to finance the persistent current account deficits that were established in the mid-1990s. It was expected that Vietnam would be able to finance an import-substituting development strategy by attracting external financing at a rate of 8–9 per cent of GDP for an extended period of time, mainly in the form of FDI inflows averaging more than US $2 billion per year. However, this forecast turned out to be severely wrong, partly because the Asian crisis made investment capital more scarce, and partly because inflows of FDI fell as a result of the weaker than expected performance of many foreign-invested enterprises in Vietnam. As a result, FDI inflows stayed below US $800 million in 1998–2000.[1]

Third, the contributions of Vietnam's donor community have met or even exceeded the expectations from PFP (1996), in spite of the temporary setbacks in the relations with multilateral donors when the structural adjustment programme was halted in 1997. ODA disbursements have grown rapidly since the relations with the World Bank and IMF improved in 1999, with annual inflows of grants and soft loans exceeding US $1 billion since that time. In addition, private transfers have increased significantly since 1999, although reliable data are hard to come by: the figures for private transfers are estimates, since only the part that is transferred via the official banking system is officially recorded.

How sustainable is Vietnam's export recovery? With preliminary data for 2001 in hand, there is reason for some caution. Export expansion has slowed down in tandem with the international business cycle – overall export growth was only 4 per cent in 2001 and exports fell significantly in early 2002 – and it is hard to extrapolate long-term trends from developments during the last three or four years. The main reason is that the international oil price has had a profound impact on Vietnam's exports and imports. The dramatic increase in international oil prices in 1999 translated into nearly 70 per cent increases in export earnings from oil during the following two years (so that oil now accounts for about a third of total exports). This means that nearly half of the total export growth during these two years was due to the increase in oil exports. Similarly, the slowdown in exports in 2001 and 2002 has to some degree been related to falling oil prices. Hence, it is difficult to forecast Vietnam's trade performance in the medium term, since the international oil price is a completely exogenous variable. At the same time, it is notable that the fluctuations in non-oil exports have been smaller, although there are distinct differences between industries. Some sectors, such as garments, footwear and seafood, have recorded reasonably healthy growth through 2001, while others, like electronics, rice and other agricultural products, have suffered from heavy price declines since 2001. Performance in these sectors is still to a great extent determined by the Vietnamese policy environment, and the policy reforms discussed above give cause for some optimism regarding the future. Although the continuing slump in Organisation for Economic Co-operation and Development demand and the tough competition from China are difficult challenges, trends in this area are positive.

State enterprise reform

The state sector continues to dominate the Vietnamese economy, in spite of the gradual shift towards a market economy through the reform period, and despite the emphasis on SOE reform and privatisation in the structural adjustment programmes formulated since the mid-1990s. One reason is that the official political doctrine is still communism, and public ownership of the means of production – at least in 'strategic' sectors – remains an important element of the ideology. Vietnam's SOEs have also proved to be more resourceful than has been the case in many other transition economies. The share of large, centrally controlled SOEs was small until the mid-1990s, and most enterprises in the state sector were instead controlled by provincial and municipal authorities. In most cases, it was even possible to identify the specific 'owner' of an SOE – a ministry, a local People's Committee, an army division, or some other part of the public sector or Party organisation. This decentralisation of decision-making, with considerable managerial autonomy in operations as well as financial matters (including the right to decide how a significant share of the profits were to be used) explains why many SOEs were able and willing to respond to post-*doi moi* opportunities (Mallon 1996). Hence, in many ways, Vietnamese SOEs have resembled Chinese township and village enterprises rather than Soviet-style state enterprises.

This notwithstanding, the SOE sector suffers from many problems that are more or less generic to state enterprises in developing countries. Soft budget constraints, restricted competition and the ability to influence the policy environment have resulted in severe debt problems and weak productivity growth. Some SOE dominance is at the expense of the private sector. Only very recently has the private sector been officially recognised as an important element of the economy; SOEs are still favoured by various rules and regulations, particularly related to land holding and financing.

The dominant position of the state is confirmed in official statistics on the Vietnamese economy. Table 6.3 shows that the aggregate GDP share of the state sector hovered around 40 per cent during the second half of the 1990s. This is only about 4 percentage points lower than the state share in 1986, although the country's GDP has more than doubled in real terms since that time (Mallon 1997). Most state sector activities are found in the relatively fast-growing parts of the Vietnamese economy, namely industry and services. Less than 250,000 of the 3.4 million state employees are in agriculture, while about 1.7 million are engaged in SOEs, most of them in manufacturing. The non-state sector, on the other hand, is overwhelmingly agricultural. Nearly 70 per cent of Vietnam's 33 million-strong non-state labour force is employed in agriculture, producing less than one-quarter of the country's total output.

The apparent state dominance is less overwhelming if we look separately at the industrial sector (Table 6.4). SOEs accounted for more than 50 per cent of industrial output in the mid-1990s, but their share had diminished to about 42 per cent by 2000.[2] The main reason was slower growth and productivity development in SOEs than in foreign-invested enterprises, which increased their output share from 25

Table 6.3 GDP by sector and ownership, 1995–2000 (per cent of GDP)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*
GDP	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
State	40.2	39.9	40.5	40.0	38.7	39.0
Non-state	59.8	60.1	59.5	60.0	61.3	61.0
Agriculture	**27.2**	**27.8**	**25.8**	**25.8**	**25.4**	**22.9**
State	1.2	1.3	1.1	1.1	1.0	...
Non-state	26.0	26.5	24.6	24.7	24.4	...
Industry and construction	**28.8**	**29.7**	**32.1**	**32.5**	**34.5**	**36.6**
State	14.5	14.4	15.4	15.4	15.5	...
Non-state	14.3	15.3	16.7	17.1	19.0	...
Services	**44.1**	**42.5**	**42.2**	**41.7**	**40.1**	**39.1**
State	24.6	24.3	23.9	23.5	22.2	...
Non-state	19.5	18.3	18.2	18.2	17.9	...

Sources: IMF (2000); IMF (2002).

Table 6.4 Industrial production by ownership, 1995–2000 (per cent of industrial production)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*
State sector	**50.3**	**49.3**	**48.0**	**45.9**	**43.4**	**42.0**
Non-state sector	**24.6**	**24.0**	**23.1**	**22.1**	**21.9**	**22.4**
Co-operative	0.6	0.6	0.6	0.6	0.6	...
Private	2.2	2.4	2.4	2.2	2.2	...
Household	17.6	16.1	14.7	13.8	13.0	...
Mixed	4.2	5.0	5.5	5.5	6.1	...
Foreign-invested sector	**25.1**	**26.7**	**28.9**	**32.0**	**34.7**	**35.5**

Sources: IMF (2000); IMF (2002).

per cent to 35 per cent between 1995 and 2000. The sluggish performance of the SOE sector is closely related to weaknesses in technical and management skills, as well as to the bottlenecks that emerged between 1997 and 1999 when the Asian crisis led to the tightening of import restrictions. However, as noted earlier, several problems were evident already before the Asian crisis hit the region. Most importantly, the state sector had not managed to create any significant increase in employment opportunities since economic reforms were launched in the mid-1980s. The inward-oriented trade regime encouraged investment in capital-intensive import-substituting industries where few jobs have been created. Pool (1999) reports that state enterprises accounted for over 85 per cent of the total registered capital of all new firms established between 1991 and 1997. Yet, employment in state enterprises decreased from 1.9 million to 1.8 million jobs during the same period, although the total labour force increased by about 6 million people. The average capital cost to create one new job in SOEs during this period

was about US $7,500, whereas each new job in private small and medium-sized industrial enterprises cost US $1,000–2,000.

Another problem has been the accumulation of large debt, including non-performing debt, in the SOE sector. The IMF (1999) reported that at least two-thirds of the SOEs were classified as permanent or temporary loss-makers in 1997, and that the aggregate debt of the SOE sector exceeded its total assets by a wide margin. It was also estimated that the non-performing loans (NPLs) in state-owned commercial banks amounted to 30–5 per cent of their total lending already in 1997, before the Asian crisis, with a somewhat higher figure for joint-stock banks (IMF 1999: 29). If these estimates were correct, Vietnam's problems with bad credit were worse than those of Thailand and Malaysia before they were hit by severe financial crises in 1997. The situation has probably improved somewhat since that time, but information is scarce and official figures tend to underestimate the problem: still, official data reveal that some 10 per cent of outstanding bank loans were overdue in 2001 (IMF 2002: 75).

One explanation for the weak performance of the state sector is that Vietnam has no comparative advantages in many of the industries where import-substituting SOEs operate. An added problem in many of these sectors is that smuggling is highly profitable – the difference between domestic and international prices is large – which cuts into the profits of SOEs. Another problem is that many SOEs are also shielded from domestic competition – through various rules, regulations and administrative practices that discriminate against private firms – meaning that there is relatively little pressure on them to meet high performance standards. Furthermore, many Vietnamese SOEs do not appear to be subject to hard budget constraints. Loss-making SOEs have systematically been rescued through the write-off of non-performing loans and cash injections from state-owned banks, the National Investment Assistance Fund, Social Security Funds, and other sources. For instance, the IMF (1999) noted that several of the most severely indebted SOEs were able to increase their total outstanding debt by 50 per cent or more in 1997, mainly by recourse to the state banking system. The softness of budgetary constraints is particularly problematic because the incentives for SOE managers to maximise profit are weak (for a more detailed discussion, see Chapter 7 in this volume).

While equitisation will be helpful in severing the intimate connection between various levels of government and individual enterprises, it is uncertain how much it will contribute to the overall problems in the SOE sector. First, it is not likely that the equitisation and divestment targets will be met. There is still some resistance against equitisation, particularly from employees and managers who feel that jobs in the state sector are more secure. This type of resistance will remain as long as the actors in the market feel that there is no level playing field for all types of firms. Hence, the success of SOE reform is to a great extent dependent on the business environment for the private sector.

Second, although the equitisation programmes involve many enterprises, they are mainly small and medium-sized, and play a limited role for economic development in general. Together, the National Corporations and Special Corporations

absorbed around 2,000 of the 6,300 SOEs that existed at the end of 1994. They account for an estimated 50 per cent of employment and some 80 per cent of the resources and production capacity in Vietnam's SOE sector. The motives for the establishment of these conglomerates were to secure the leading role of the public sector by establishing state control over a number of strategic industries, to achieve economies of scale in production and management, and to make it possible for Vietnamese SOEs to compete on a more equal basis with foreign multinational corporations (Mallon 1996). The problem is that it is not obvious how attempts to centralise management and reduce competition in important industries will lead to the necessary improvements in technical and financial performance. Not surprisingly, a review of the National Corporations conducted in early 1999 noted serious problems related to low productivity, high costs and the emergence of monopolies. However, the review did not conclude that restructuring would be needed. Instead, it was proposed that the National Corporations should be maintained and strengthened: in practice, this meant more bank credits and higher barriers to competition. It is estimated that the government provided about 2.2 per cent of GDP annually between 1997 and 1999 in supplementary capital, subsidies, tax exemptions, debt write-offs and preferential credits to the SOE sector (World Bank 2000a). Against this background, it is likely that SOE reform will remain a medium-term problem area.

Private sector development

In addition to the continuing dominance of the state sector, Table 6.4 also shows the small share of the private sector in industrial output. The aggregate share of private firms fell from nearly 25 per cent in 1995 to 22.4 per cent in 2000. This reflects the complicated business environment in Vietnam, where the domestic private sector has been struggling not only against a complex bureaucracy but also against SOEs with various privileges. Moreover, the bulk of the private sector is made up of household enterprises, which operate at a very small scale and with very simple technologies. The perhaps most remarkable characteristic of the private manufacturing sector is that only 466 private firms had managed to grow to a size exceeding 100 employees in 1998. Few of the largest firms sought their customers on the domestic Vietnamese market, presumably because they were unwilling or unable to challenge the SOEs active in these markets: instead, they were largely focused on food and beverages, garments, leather products, and wood products for exports (Webster and Taussig 1999).

The complex and thoroughly regulated business environment in Vietnam has made it difficult to identify the relative importance of various obstacles to enterprise development. Still, it is easy to recognise several problem areas that appear frequently in discussions about private sector development. A core issue concerns the legal framework for land use rights. According to Vietnamese law, all land belongs to the people and is administered by the state. Individuals and companies may have a legal right to use land, but never to own land. The right to use land is documented in special land use certificates, which define the accepted uses of the

land for example, agriculture, industry or housing. These certificates can be traded with some restrictions, as well as inherited. They are also required if land is used as collateral. Without a certificate, firms – especially new firms – will find it very hard to secure loans from the banking system, and they will be restricted to operating on leased land, where the long-term user rights are uncertain.

Private enterprises have typically found it very hard to obtain the documents required for land use certificates, particularly in urban areas. There are many complaints about the lack of a unified public registration system for the transfer, lease and mortgage of land. The government approval process for each application for land use rights has been cumbersome, arbitrary and discriminated against private enterprises. The value of land use rights has been determined administratively by governmental officials, rather than by market forces, and land lease procedures have varied from place to place. In urban areas, long-term land use rights have mainly been allocated to SOEs. This has enabled them to obtain the bulk of the credits from the banking system, and also enhanced their ability to form joint ventures with foreign investors. In many cases, the only tangible contribution of the Vietnamese partner has been their land use rights, which have surprisingly often been valued at 30 per cent of the total project value. Private enterprises have not been attractive as joint venture partners because they have rarely had any land to offer – and, of course, because foreign investors have been well aware of the less-than-whole-hearted official support for private firms.

Another central problem area is taxation. Complaints about the complicated tax system, with differential sales tax rates for different sectors and much scope for discretion in assessing tax rates, were common before 1999. Some of these complaints have been abated by the introduction of value-added tax (VAT) at the beginning of 1999. However, complaints regarding profit taxes remain. Profit tax rates differ between business activities, but there are also differences between different types of enterprises in the same economic sector. For example, profit tax rates on domestic private enterprises are often twice as high as tax rates levied on foreign-invested projects and SOEs.

Other common complaints focus on the extensive licensing requirements in all areas of business. At the beginning of 2000, it was estimated that the Vietnamese authorities required some 400 various kinds of licenses from domestic companies, many of which – such as printing and photocopying licenses – applied to several areas of business. Although around 150 types of license were dropped from the books that year, the remaining 250 licenses constitute a significant administrative burden for most firms. They also introduce an element of uncertainty into business planning, because of the discretionary decision-making practices of Vietnamese authorities. Complaints about red tape and corruption are still common, as are complaints that the Vietnamese legal system has been assessed as one of the weakest in the region.

For domestic businesses, however, the greatest problem is access to investment finance. Analysing financing in a sample of 371 private enterprises, Ramamurthy (2001) noted that the great majority of enterprises relied on personal and family savings for investment and working capital. More than half of the

surveyed enterprises relied solely on their own savings for the initial capital requirements. Only a few of the most successful enterprises were able to access credit from banks and other financial institutions; even in these cases, loans were small and of short maturity. Worker contributions, interest-free loans from friends and relatives, and loans from the informal sector were all much more important than the formal banking sector as sources of credit.

Most available formal credit resources have been directed to SOEs, many of whom have had problems servicing their debt. The resulting NPL problems have forced banks to restrict lending to all but their most strategically important customer: the state. Banking rules have directly discriminated against private enterprises, which need collateral to obtain loans – SOEs do not – and pay higher rates of interest than SOEs. Another reason is the low level of development in the private sector: the credit risks connected to loans to private small and medium-sized enterprises (SMEs) are high because of the unfavourable business environment. Investment capital remains a scarce resource in Vietnam because the banking system has not been very successful in absorbing domestic household savings. Pool (1999) reports that while domestic savings increased from 7.4 per cent of GDP to 16.5 per cent between 1990 and 1997, domestic banks only managed to attract one-fourth of these savings. The rest was reportedly kept in mattresses, invested in inventory and real estate, or channelled through the informal financial sector. Restricted access to credit has made private industry very self-sufficient – the average ratio of debt to assets among SMEs is around 25 per cent, compared with 60 per cent for SOEs – but it has also restricted its growth potential. Where the bulk of finance comes from retained earnings, only the most successful companies are able to expand and invest in reasonably modern technology.

While SOE reform has been erratic and sometimes disappointing, certain aspects of private sector reform have progressed surprisingly fast. A revision of the Law on Promotion of Domestic Investment in 1998, together with the implementation of the new Enterprise Law in 2000, have had a strong positive effect on the growth of formal private enterprise. The investment law provided new incentives for domestic investment, while the latter has contributed to a transformation of the business licensing system into a business registration system, with automatic approval of all applications that fulfill the requirements. Together with the elimination of nearly 150 business licenses that restricted entry in different sectors of industry, this has led to a very large increase in the registration of new private SMEs. Over half of the country's 70,000 SMEs have been registered since January 2000, with perhaps one-fifth of the new enterprises in manufacturing. It is likely that a large share of these new formal sector enterprises were former household enterprises, which means that the actual increase in private sector activity is smaller than the number of new SMEs indicates. Nevertheless, the growing propensity to register into the formal sector is encouraging. As long as household enterprises remained in the border area between the formal and informal sector, they were not able to qualify for external credit, sign long-term agreements with customers and suppliers, and employ additional workers in the formal labour market. The fact that a large number of household enterprises have decided to register as formal

enterprises indicates that they expect a future business environment with significant earnings and growth potential. In addition, as noted by the World Bank (2002:16), the emerging private sector has outperformed the state sector in both employment creation and export growth in the last few years.

Another important development is the increase in donor support for capacity building in the private sector. Several donor-funded projects are now actively promoting the development of private SMEs and providing business development services to the Vietnamese private sector. In addition to several bilateral projects, major ventures have been established by the United Nations Industrial Development Organisation and the International Finance Corporation. The Vietnamese government itself has also set up several bodies to support and supervise development in the sector. One of the more notable bilateral initiatives has been taken by the Japanese, who are promoting private sector development through the Miyazawa plan. This plan was set up to support the post-crisis recovery of the Asian economies, and the US $400 million pledged to Vietnam are tied to a broad programme aiming to facilitate SME development.[3] The establishment of the Private Sector Forum, a non-governmental body bringing together domestic and foreign private investors, government, non-governmental organisations, and donors, is another initiative that has contributed to a more lively and open discussion on private sector development.

The cautious – and very slow – reforms in the financial sector are also potentially important for private enterprise. The most visible reform has been the introduction of a stock market in July 2000. Although it only lists some 20 companies at present, it provides an important signal regarding future reforms. In addition to an increase in the number of listed companies, it can be expected that an over the counter (OTC) market will be established in the future. The requirements for transparency and accounting practices on the regular stock market are considered too demanding by many firms, and an OTC market with somewhat less stringent rules would be a suitable first step for many firms. The number of company shares in circulation is also increasing rapidly with the progress of the equitisation programme, and there is presently no official market for these equities.

Banking reform has progressed relatively slowly, which is not surprising considering the likely extent of NPLs in the system, but the plans for future reform are ambitious and important. The banking reform plan includes measures to restructure joint-stock banks and to reduce their number from 52 in 2000 to about 25 in 2003. (Thirteen joint-stock banks had been closed or merged by mid-2002.) The plans also include restructuring of the four state-owned commercial banks, with focus on modern accounting practices, annual independent audits, increased managerial accountability, phasing out of non-commercial lending, loan-loss provisioning, recapitalisation, and other measures to implement commercial operating principles. Many of these measures were called for already in PFP (1996), and the fact that they are not addressed seriously until the present time testifies to the great difficulties involved. It is likely that measures on two fronts are needed to improve the private sector's access to capital. One essential reform requirement is to sever the connection between loss-making SOEs and the banking system, to

avoid further weakening of the banks' balance sheets in the next few years, when the level of competition and losses in SOEs are likely to increase. In addition, it may be necessary to establish entirely new financial institutions focusing on the private sector. It is unlikely that the existing banks will manage their debt burden in time to provide the necessary support to the private sector during the coming five years (although the share of bank credit going to the SOE sector shows a clear downward trend).

There are several other areas where progress has also been relatively slow. Land regulations should be revised to make it easier for private firms to obtain land for their business needs, and to use land as collateral for bank loans. Tax regulations, particularly for profit taxes, should be simplified, and the tax treatment of private and public enterprises should be equalised. Vietnamese science and technology centres should be encouraged to establish networks with private business, to facilitate the diffusion of modern technologies. Yet the experiences of private sector reform from the last few years are positive, and it is likely that these challenges can be managed given the requisite political will.

Conclusion

This chapter has offered a brief assessment of selected economic developments in Vietnam since the Eighth Party Congress in 1996. The focus has been on some of the structural reform areas that were identified as development challenges in the mid-1990s by Vietnamese authorities and the donor community: trade policy and the roles of the state and the private sector.

The discussion has shown that there has been significant progress in two of these areas. Trade reform has been faster than expected in the mid-1990s, and trade performance has also been much better than predicted half a decade ago. Assuming that external developments are not too unstable, there is reason to expect further progress in this area. Negotiations for WTO membership have commenced, and the increasing export orientation of foreign investors and private entrepreneurs is likely to yield continued growth. Private sector development has also been surprisingly successful in recent years. The new Enterprise Law from May 1999 has contributed to tremendous growth in the formal private sector, and the continuing efforts to strengthen the business environment look promising. The role of the private sector has now also been recognised at the highest policy-making and symbolic levels: the constitution was amended in 2002 to give equal status to the private sector and the state sector (World Bank 2002: 22). The remaining challenges are mainly related to the financial sector, where debt problems and links between state-owned banks and SOEs are slowing down necessary reforms.

SOE reform has also been slower than prescribed in various plans and strategies. Despite some progress in the equitisation programme, there has been little progress in other areas. Moreover, only a relatively small share of state capital will be privatised: the sectors identified as strategically important (and therefore earmarked for SOEs) already account for some three-quarters of SOE capital. The reason for the limited progress is clearly resistance from interest groups that fear losing

their privileges, either related to 'ownership' of state enterprises, or employment in state enterprises. Earlier SOE reforms have met more resistance than expected, and Vietnam lacks domestic interest groups that are able and willing to counterbalance the influence of SOE proponents. It is therefore possible that future strategies should focus on the development of the private sector while accepting more gradual reform of the SOE sector.

Although trade reform, SOE reform and private sector promotion are essential to achieve rapid and sustainable development in Vietnam, it should be noted that the discussion above only covers a small step on the road towards a more developed society. In the long run, reforms will also be needed in several other areas. The education system needs to adjust to the requirements of a more modern economy. For instance, vocational training programmes will be demanded as soon as the private sector moves into industrial production with higher skill requirements. The demand for business training already exceeds supply. Science and technology policies must be revised to provide the necessary inputs for a rapidly developing industrial sector. Reforms in the labour market will be needed to create stronger links between productivity and wages. Social sectors need to be strengthened, not only to protect redundant workers when SOEs are reformed but, even more importantly, to provide equal opportunities to all citizens in the areas of health care and education. Carefully designed support programmes are needed to reduce poverty among the most disadvantaged groups in Vietnamese society, in the urban informal sector as well as in rural areas far from the main metropolitan regions. These are all formidable challenges for the coming years.

Notes

1 The large sums recorded for debt rescheduling and arrears in 2000 are related to the renegotiation of rouble debts to the former USSR.
2 It is difficult to provide an accurate description of ownership structures in the manufacturing sector, since many FDI projects are set up as joint ventures with SOEs. For instance, Webster (1999) classified joint ventures into the state sector, which raised its shares of manufacturing GDP to well over 50 per cent. Moreover, several SOEs have started new companies that are often registered as private firms although they are financed with state capital.
3 It is likely that the 'carrot-and-stick' approach implicit in the Miyazawa plan facilitated several of the reforms set up in connection with the new Enterprise Law.

7 The social challenges of reform

Restructuring state-owned enterprises in Vietnam

Gerard Clarke

Seventy kilometres south of Hanoi lies Nam Dinh, Vietnam's 'textile town', a grim, sprawling industrial city with a population of 250,000 – home to the Nam Dinh Textile Company (Natexco), Vietnam's oldest, largest and proudest integrated garment and textiles company. Established in 1889, Natexco became one of Vietnam's industrial behemoths after the introduction of central planning in 1954; by 1988, 17,000 people were employed in its spinning, weaving, dying, sewing and other factories. As Nam Dinh's main employer, the company provided housing for a quarter of the town's population in its 4,000 apartments and maintained five crèches, three schools, a hospital and a holiday home by the coast for workers and their families. When market reforms were introduced in Vietnam in the late 1980s under the banner of *doi moi*, Natexco was poorly placed to cope. The company's mainly Chinese machinery was so antiquated – and production so inefficient – that Natexco sold the cotton yarn it spun to other state enterprises, substituting imported yarn for its own weaving workshops.

By 2000, Natexco's workforce had been cut to 7,000 and its housing, education and health care obligations transferred to other state agencies. A new spinning factory with Japanese machinery opened in 1993, and other plant and machinery was modernised with aid from the Dutch and Belgian governments. By 2000, the company was producing 10,000 tons of yarn per year and exporting garments to Japan, Europe, Russia and South Korea. The company remained loss-making, however, its products shunned by Vietnamese consumers in favour of the outputs of more efficient producers in the state and private sectors alike. Its buildings, some dating to the end of the nineteenth century, were dilapidated, its plant and machinery still inefficient and expensive to maintain and its factories still overstaffed. At a time of general economic hardship throughout Vietnam in the aftermath of the 1997 East Asian economic crisis, the company remained handicapped by its traditional responsibilities as the city's largest employer.[1]

State-owned enterprises (SOEs), as the example of Natexco illustrates, continue to represent a key component in Vietnam's ongoing reform process. Vietnam still has a small formal domestic private sector, accounting for less than 4 per cent of gross domestic product (GDP), 6 per cent of manufacturing output and 3 per cent of total employment (World Bank and ADB 2002: 32). By contrast, the country had approximately 5,500 SOEs in 2002, generating 38 per cent of GDP consuming